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Where Have All the Statesmen Gone?
Inequality, Populist Politics and the U.S. Economy

“As long as inequality and other social problems plague us, populists will try to exploit them.”
– Kofi Annan, Statesman

At a time when the United States economy is experiencing the second longest expansion in history, our nation is facing a most politically-divisive period as the benefits of the post-crisis recovery have not been shared equally. America is not alone in this situation as concerns about inequality and other issues have led to increased frustration and anger with government leaders in many developed nations which makes this environment ripe for populist exploitation. The global economy is suffering from too much debt and too little growth, while the policies employed to combat the financial crisis have contributed to rising income inequality both in the U.S. and other developed nations. For too long, our government has placed too much responsibility for economic growth on the Federal Reserve, and productive fiscal policy initiatives have not been created to break out of the current slow-growth cycle. While the battle lines are being drawn for the 2020 presidential election, this is an appropriate time to provide some perspective with respect to what is missing in the political debate and what can be done to address our country’s most pressing issues.

Notwithstanding the political climate in our country, current economic conditions of slow growth, muted inflation, and low interest rates are fostering a positive environment for the continuation of this economic expansion and for equity investing. Investors should be aware that economic expansions have no set expiration date, and the current expansion can continue for some time as evidenced by Australia’s expansion which is heading into its 28th year. By the same logic, the stock market can continue its upward trajectory given current favorable conditions for corporate earnings. The more positive view of U.S. equities is further supported by the Federal Reserve’s current accommodative monetary policy, significant efforts by the Chinese government to stimulate its economy and the increasing likelihood that the U.S. and China will reach some resolution of their trade dispute. In this slow-growth and deflation-prone environment, investors should expect continued market volatility with possibly fewer companies benefiting than in recent years. Importantly, these conditions continue to create excellent buying opportunities for investors to be able to take advantage of the mispricing of leading companies benefiting from the secular trends.
What is Missing in the Political Debate?

“Politics is the art of looking for trouble, finding it everywhere, diagnosing it incorrectly and applying the wrong remedies.”

– Groucho Marx

Many observing the political dysfunction in Washington DC would agree with the spirit of Groucho’s statement. Politicians have been too busy running for office and blaming others to acknowledge their own responsibilities for the nation’s problems and their inability to implement appropriate policies. Compounding the problem is the fact that they are unable or unwilling to grasp the linkages between education, immigration, infrastructure spending, health care costs, debt and deficits on the prosperity of the nation. For example, changes to our education system would allow for more equality of opportunity for high school students and prepare our future labor force to adapt to rapid changes in their job requirements as automation replaces current work functions. Revamping our immigration policies would allow the U.S. to more immediately address the current skills deficiency as we would be able to retain foreign students who are educated here rather than have them return home to compete against us. Long overdue improvements in infrastructure would make the U.S. more productive and competitive. Additionally, increased spending would also support our digital and educational needs. The aging of our existing work force puts even greater strains on our ability to address these issues. Without an understanding of the immediacy of the need to fix these problems, the world’s leading economy will continue to produce subpar growth, fail to reduce inequality, and squander the opportunity to use this low-interest-rate environment to invest for the future. Not addressing these needs will promote even greater economic disparity.

The fundamental requirement rests with our elected officials to set aside partisan ideology and agree on policies to generate more equitable growth. Policies can be constructed to reduce income inequality, increase disposable income for lower and middle-income earners, and drive new business investment. The combination of these factors would result in a larger economy with greater tax receipts for federal, state and local governments. Before leaving office, President Obama said, “Without a faster-growing economy, we will not be able to generate the wage gains people want, regardless of how we divide up the pie.” His assertion is that the solutions to income equality cannot be achieved by redistribution alone. The debate between growth and redistribution will be one that continues through the 2020 election.
What Can be Done to Address Inequality?

“The inequality has become the political theme/slogan of our time in both Europe and the U.S., yet political leaders do not even bother to consider that their own policies, which put the entire burden on central bankers to print money and drive up stock, bond and other asset prices, are actually exacerbating income and wealth disparity.”

– Paul Singer, noted investor

The solution begins with politicians recognizing that they are the major part of the problem. Congress needs to end the “winner-take-all” politics that currently prevail, and once again, work together to make the country richer, both economically and socially. Given the unfortunate likelihood that the Federal Reserve will have fewer tools available to address the next recession, politicians will need to act together as the U.S. may require significant fiscal policy initiatives to forestall a prolonged recession. Politicians need to set aside their ideological differences and focus on bi-partisan solutions working closely with, not against, our best business leaders. At the same time, our business leaders need to act in a responsible manner as well, and some have failed in this respect. We need to develop policies that promote the best use of tax receipts and the right system to generate more receipts for all levels of government. Education including skills training and apprenticeship programs, infrastructure, and immigration are all linked to economic growth, and effective policies are required to arrest the challenges of growing inequality and a declining middle class. Our federal government struggles to approve an annual budget, while China, our biggest competitor, has a written 5-year plan with specific programs and measurable goals. Congress must create and enact a bi-partisan, multi-year plan to address the critical and growing needs of the U.S. Such a plan must be designed to survive the bi-annual campaign cycle and deliver on our nation’s longer-term needs. The following are a few suggestions for politicians to consider that reflect some of the things they are missing today. It is neither exhaustive nor original, and that is what makes the current state of politics even more frustrating.

- **Infrastructure** – Why hasn’t Congress approved a major program to address our physical, digital and educational infrastructure needs, despite it being the one thing upon which both parties can agree? According to a 2018 Pew Research Center survey, 1 in 5 teenage students can’t always finish their homework due to the lack of access to technology. The digital divide in teens exacerbates inequality and must be addressed. Historically, discussions regarding infrastructure focused on the physical element, but digital and educational infrastructure have certainly increased in importance.
• **Skills Gap** – Why do we have 7.1 million job openings and only 6 million people unemployed? The U.S. needs programs designed to address the skills gap as well as retraining programs for jobs that are replaced by automation. Congress should also be partnering with business leaders to develop apprenticeship programs for high school students to learn trades that require skills not taught in college. A recent report by the OECD suggested that “one in six middle-income workers are in jobs that are at high risk of automation.”

• **Student Debt** – With $1.5 trillion of growing student debt in the U.S., why does the government need to charge students more than 5% interest on loans? One alternative is that the government could offer interest free loans tied to contracts with student borrowers to receive a percentage of future earnings for a set period depending on the wage levels of each job. High student debt loads work against growth and promote inequality.

• **Immigration Reform and Skilled Labor** – Why does Canada with population of roughly 38 million target a significant number of highly skilled persons out of the nearly 300,000 immigrants accepted annually, while the U.S with a population of 317 million accepts only 85,000 H-1B visas out of the more than 200,000 applications received each year? The US H-1B visa is a non-immigrant visa that allows US companies to employ foreign workers in specialty occupations that require theoretical or technical expertise in specialized fields such as in architecture, engineering, mathematics, science, and medicine. The Wall Street Journal recently reported that there are currently 732,000 unfilled information technology jobs in the U.S. Raising the quota would be an easy way to fix part of the problem. The article further stated that “in 2019, immigrants will account for one in every 3.5 patents granted.”

• **Addressing Health Care Costs** – How can the world’s most prosperous country have health care costs estimated to be more than 16% of GDP or $3 trillion annually, while the rest of the developed world averages about half of that? We have great health care for those that can afford it, but it is not great enough to warrant what it costs us relative to the spend differential with other countries. Congress needs to work with the insurers, pharma companies and businesses to develop a system that works without escalating costs. Grandstanding won’t fix the problem that has been building for years, and maybe if those in Congress used the system that the typical American does, things would be very different. JPMorgan, Berkshire Hathaway and Amazon have decided not to wait for the federal government to figure it out and are jointly developing their own health care program for their over 1 million employees.
• **Fixing the Tax System** – Why is “carried interest” for real estate and private equity owners taxed at 15% when ordinary workers are taxed at higher rates? This loophole and others like it should be closed as they are unfair and lead to misallocation of capital. The Administration got corporate taxes partially right by bringing these taxes down to the average of other advanced countries, but many small businesses are still taxed at the individual rate. Small business is a key driver of the economy and should be better supported. Additionally, some of the proposals for raising taxes on the ultra-wealthy should be considered but getting the definition of ultra-wealthy right is also important.

• **Extending Retirement Age and Benefits Eligibility** – Why have ages for retirement plans and benefits eligibility for Social Security and Medicare programs not been adjusted to reflect increased life expectancy? The NY Times recently reported that the trust funds for Social Security and Medicare both will be depleted by 2035. According the Social Security Administration website, “a man reaching age 65 today can expect to live to 84 and a woman to 86.5 years old. While about one of our every three 65-year-olds today will live past age 90, and about one out of seven will live past age 95.” In 1930, the life expectancy at birth was only 58 for men and 62 for women, and the retirement age was 65. When the social security system was created in 1935, the government did not anticipate paying out much, and now we are heading towards a deficit in the program and an even larger fiscal deficit. Government pension plans are facing similar demographic and funding problems on the federal, state and local levels. There are many possible ways to address the funding issue and adjusting the age for eligibility is one that needs serious consideration. What is Congress doing to address this worsening issue?

These are just a few of the things that should be on the to-do list of the President and Congress, and while we do not pretend to think that the solutions to our nation’s problems are easy, taking this type of approach would be far better than our current path. Our politicians must not squander the country’s unique opportunity presented by the historically low-interest-rate environment to address these pressing needs. Not acting now would represent a major failure by our elected officials. While some of the populist proposals being discussed may make for good campaign slogans, they do not address the causes or reflect the economic realities of the U.S. We are reminded of the words of economist Thomas Sowell who said, “the first lesson of economics is scarcity: there is never enough of anything to fully satisfy all those who want it. The first lesson of politics is to disregard the first lesson of economics.”
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